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Newsletter Q2

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NEWSLETTER SUBSCRIPTION

The House of Finance opened in 2008. It integrates Goethe University's interdisciplinary research on finance, monetary economics, and corporate and financial law under one umbrella. Ten academic research and training units work together in the House of Finance.

As part of its aim to disseminate research results and to promote an exchange between academics and practitioners, the House of Finance issues a newsletter on a quarterly basis.

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EDITORIAL

The global financial crisis has come to be seen not only as the most severe financial and economic debacle since the Great Depression of the 1930s. It also, according to many commentators, marks a fiasco in terms of how central banking has been perceived after the collapse of the Bretton Woods system. Central banking will never be the way it was before 2007, many believe.

Criticism has been aired that the focus of central banks on short-term inflation forecasts has turned out to be flawed and that the monetary laxity of the past is one of the root causes of the crisis in that it encouraged risk taking and contributed to the build-up of financial imbalances and asset price bubbles. Moreover, there are views that hard-earned central bank independence has ultimately been sacrificed since central banks have coordinated policies closely with fiscal authorities in forestalling a major economic and financial collapse.

True, the liquidity measures taken by the ECB were unthinkable, if measured by how the Eurosystem was designed to function. The ECB provided unlimited liquidity support to banks against less liquid collateral, it purchased governments and private sector debt in secondary

markets and it cut its policy interest rates to lows not seen in generations so as to be able to prevent the financial system from seizing up and to avoid the emergence of deflationary risks.

On top of all this, the ECB was involved in drawing up adjustment programs in the context of the sovereign debt crisis for countries that had to apply for financial help from their European partners and the IMF. Finally, since the beginning of this year, the ECB has been supporting the European Systemic Risk Board (ESRB) in the monitoring of systemic risk that may arise from the macroeconomic environment and from within the financial system.

However, all these developments have not changed the ECB's core task. The ECB's primary mandate is to safeguard price stability. It is indisputable that the financial crisis has shown the shortcomings of inflation targeting strategies that focus unduly on short-term inflation forecasts and neglect developments in the financial sector. In this respect, the ECB has always based its monetary policy decisions on a broad set of indicators, including developments in money and credit, with a view to pursuing price stability over medium-term horizons. It was on the basis of this strategy

that it had warned about the risks emerging from double-digit growth rates in money and credit, as observed well ahead of the crisis.

The majority of the countries participating in EMU are now about to overcome the economic and budgetary consequences of the crisis. The economic recovery in the euro area has been sustained and is becoming more broadly based. The economy no longer needs the degree of economic or monetary stimulus that had been adopted at the height of the crisis in late 2008 and early 2009. Inflation, expressed in terms of the EU's Harmonised Index of Consumer Prices, is currently higher than the level that the ECB would consider to be in line with price stability. Financial asset prices are now virtually back to where they were before the crisis.

The ECB has taken account of these developments and allowed most of its liquidity support measures to expire. As exemplified by the decline in the size of its balance sheet, it has gradually been stepping back from the prominent role it has played as an intermediary in the interbank market. Likewise, it has started to withdraw monetary stimulus by raising interest rates in April 2011.

The challenges that appear to have rocked the world of central banking in the view of many observers have, in fact, been confronted by central banks before – especially that of operating independently of political influence and ensuring price stability in an environment of highly vulnerable public finances.

It is clear that the ECB does not operate in a political vacuum. But any blurring of responsibilities between national governments and the ECB would be detrimental. Addressing sovereign debt problems is outside the remit of central banking, and this must remain so, if the euro is to continue to be a sound currency. If countries want to reap the benefits of EMU participation, they need to come to terms with the reality of a sound common European currency managed by an independent central bank.



Jürgen Stark
Member of the Executive Board,
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WHY DOES THE EQUALLY WEIGHTED PORTFOLIO OUTPERFORM THE VALUE- AND PRICE-WEIGHTED PORTFOLIOS?



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Investors are traditionally searching for “alpha”, defined as a return in excess of that warranted by the systematic risk undertaken, and managers are traditionally evaluated on the basis of their ability to beat the market, preferably without being exposed to significant risks. Several years ago, the financial industry faced a puzzling result of DeMiguel, Garlappi, and Uppal (2009) that the performance of the equally weighted equity portfolio is no worse than that of a number of optimal portfolio choice models. As its name would imply, the equally weighted portfolio divides the investment among the assets equally, and hence it is one of the simplest investment rules available to portfolio managers. While being simple, the equally weighted portfolio outperforms the traditional value- and price-weighted portfolios in terms of Sharpe ratio and Jensen's alpha (see the comparative performance of the three sample portfolios over the last 40 years in figure 1).

Responding to the interest shown by the investment community, we analyze three of the

simplest weighting rules (for an equally, value- and price-weighted portfolio) to understand what features of the equally weighted portfolio account for its consistent outperformance. In our conversations with colleagues, we often hear that the explanation is obvious – the equal-weighting rule assigns higher weights to small stocks compared to the weights of the same stocks in the value- and price-weighted portfolios. Embracing this idea, we look at the composition of each portfolio in terms of stock characteristics that have been shown to predict cross-sectional returns. Moreover, we look at the systematic risk of each weighting rule to understand how much of the performance can be attributed to the bearing of systematic risk and how much is idiosyncratic. To determine the source of the idiosyncratic return component, we also look at the distinctive feature of the equal-weighting – periodic rebalancing of the stocks in order to maintain equal weights. Thus, our analysis studies three underlying channels through which the weighting rule may affect the performance of a portfolio: (i) the cross-sectional relation between stock characteristics and expected returns; (ii) the systematic risk of the equally weighted portfolio in

terms of factor exposure and its relation to the remaining idiosyncratic risk; and (iii) the contrarian nature of the equally weighted portfolio relative to the trend-following behavior of the value- and price-weighted portfolios.

To undertake our analysis, we construct equal-, value- and price-weighted portfolios from the stock constituents of three U.S. stock indices – the S&P500, the S&P400, and the S&P600, which contain large-cap, mid-cap and small-cap stocks, respectively. We then compare the performance of these portfolios and find that the equally weighted portfolio consistently outperforms the price-weighted portfolio, which, in turn, outperforms the value-weighted portfolio in terms of four-factor alpha, average return, Sharpe ratio, and certainty equivalent.

In brief, the picture is rather more complicated than that predicted by our colleagues – small stocks definitely help explain some of the good performance of the equally weighted portfolios, but they do not tell the whole story. We find that there are three major performance drivers of the equally weighted portfolio, compared to the price- and value-weighted portfolios.

(i) A larger proportion of relatively small stocks, high book-to-market stocks, and stocks characterized by more pronounced reversal (defined as the return in the past month).

The equally weighted portfolio assigns relatively higher weights to smaller stocks than the value- and price-weighted portfolios. Because of the fact that the stocks of smaller companies have historically tended to earn higher returns than those of larger companies, the equally weighted portfolio outperforms portfolios with a higher proportion of large-cap stocks. A vast amount of empirical literature (e. g., Fama and French (1992), among others) has shown that other company and stock characteristics are also linked to stock returns. We find that, in addition to size, price, liquidity and idiosyncratic volatility also account for why equally weighted portfolios demonstrate a superior performance to value- and price-weighted portfolios.

(ii) A different exposure to the systematic factors and a greater proportion of the idiosyncratic portfolio return with respect to and beyond the three factors of Fama and French (1993) and the momentum factor of Carhart (1997).

To understand how the weighting is related to the risk profile, we look at the differences in the exposure of our portfolios to the standard market, size ("small-minus-big") and value ("high-minus-low") factors of Fama and French (1993), as well as to the momentum factor of Carhart

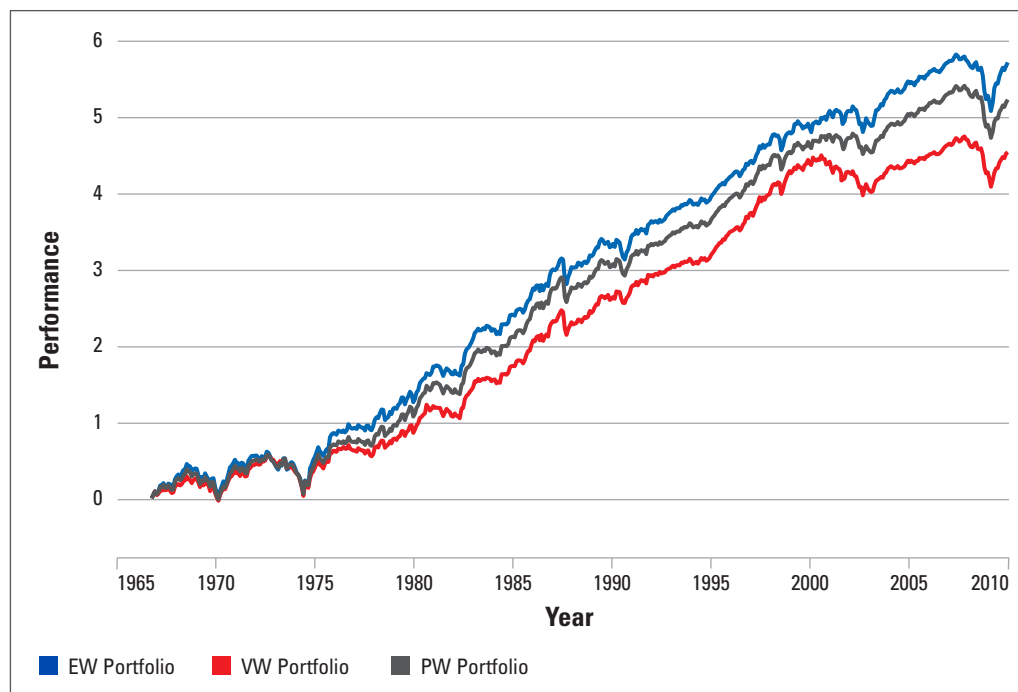


Figure 1: Performance of an equally weighted portfolio compared to a value- and a price-weighted portfolio

(1997). We find that the different weighted portfolios do indeed differ in their exposure to these factors. As expected from the analysis of characteristics, the equally weighted portfolio loads more positively on the size and value factors, and more negatively on the momentum factor, compared to the value-weighted and price-weighted portfolios. However, the change in exposure to the systematic factors does not fully explain the differences in the expected/average realized returns of each type of portfolio.

(iii) The contrarian nature of the equally weighted portfolio that arises due to the periodic rebalancing of stocks required for equal weights.

To complete the picture, we examine the effect on performance of the contrarian nature of the equally weighted portfolio relative to the trend-following behavior of the value- and price-weighted portfolios. We find that the contrarian nature of the equally weighted portfolio is important for its performance, and that the rebalancing period is

a crucial factor determining the alpha of the equally weighted versus the value- and price-weighted portfolios. The ability of the equally weighted rule to take advantage of the reversal in prices is responsible for beating the factor models, i. e., for generating the factor alpha of the strategy.

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<http://ssrn.com/abstract=1787045>

SOLVENCY II: PRINCIPLES-BASED LAW, LEGAL OBJECTIVES AND PROPORTIONALITY



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The Solvency II project has been in the making since 2001. With this, the European legislator seeks to reform the present insurance supervisory regime of the European Union in order to create a framework that is more risk-based, more transparent, and that allows for rules to be applied and amended more flexibly. It involves major innovations in three areas: (i) the calculation of capital requirements, i.e. the amount of capital that an insurance undertaking has to maintain in order to cover the risks inherent in its business (“quantitative” requirements); (ii) the rules regarding the governance system of the undertaking and also the activities of supervisory authorities (“qualitative” requirements); and (iii) the supervisory reporting and public disclosure duties of an insurance undertaking.

Solvency II is implemented using the so-called “Lamfalussy process”, a special legislative technique. It aims – generally speaking – at laying down a regulatory issue in different legal statutes. Thus, it allows for essential basic regulation to be stipulated in a framework direc-

tive (the first level of the process) and for more detailed technical rules to be incorporated into regulations or directives by the European Commission that are easier to amend (the second level). As to its legislative part, it is envisaged that the Solvency II project will be finalized on a preliminary basis by 1 January 2013. Thereafter, the Solvency II Directive adopted in 2009, as well as the more detailed technical rules that are currently being developed by the Commission, will become applicable.

PRINCIPLES-BASED LAW: A CHALLENGE FOR INSURERS AND SUPERVISORS

A major change is that future rules will follow a so-called “principles-based” approach. Contrary to the present rules-based regulation, which is primarily governed by detailed statutes, principles-based law is essentially characterized by the utilization of general, vague legal terms, such as “adequate” or “proportionate”. The approach seeks to grant the supervisory authorities more leeway in the application of the law and to allow for greater flexibility, so that all the circumstances of a particular case, especially the individual business model of the insurer and its unique risk profile, may be given

ample consideration. Due to this legislative shift, the legal objectives of Solvency II gain great importance, since they will serve to determine the scope and content of a principles-based provision. Moreover, principles-based rules need to be applied in a proportionate manner, vigilantly taking into consideration the various aspects and particularities of the individual case. Hence, for the successful design and application of future Solvency II rules, it is of utmost importance that all the authorities concerned give due consideration to the underlying legal objectives and the proportionality principle. Regrettably, the Solvency II Directive raises a number of questions in this regard.

WHAT ARE THE LEGAL OBJECTIVES OF SOLVENCY II?

The Directive explicitly names the “protection of policyholders and beneficiaries” as the main objective of insurance supervision. The term “supervision” encompasses both supervisory regulation as well as the application of the Solvency II rules by supervisory authorities. In addition to the main objective, the Directive explicitly mentions other so-called “secondary objectives”, i. e. financial stability and the prevention of procyclical effects. Thus, even

though the interventional powers of insurance supervisory authorities remain restricted to insurance undertakings, the European legislator has also assigned to them the responsibility for safeguarding other financial sectors and the financial system, as a whole. It comes as a surprise that, even though policyholder protection is defined as the main objective, the Directive refrains from prescribing the concrete level of protection that the supervisory authority has to safeguard (e. g. minimum, optimum, or, as in Sec. 81 para. 1 s. 2 of the German Insurance Supervision Act, sufficient protection). Thus, the Member States seem to be empowered – at least to a certain degree – to set a national level of protection themselves, which does not exactly foster regulatory convergence throughout the EU.

SOLVENCY II AND THE PROPORTIONALITY PRINCIPLE

The successful implementation and application of Solvency II is contingent on proper observance of the proportionality principle. Provided that the Solvency II Directive is itself proportionate, the principle of proportionality has two additional areas of application: (i) in the design of legislation by the Commission at

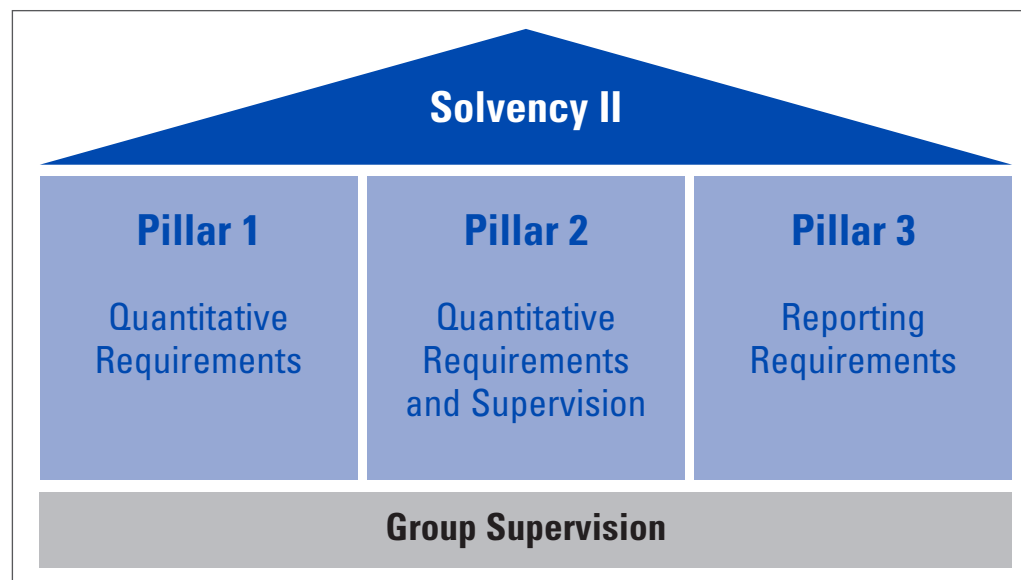


Figure 1: The 3 pillar approach of Solvency II

the second level of the Lamfalussy process; and (ii) in the application of the Solvency II provisions by supervisory authorities. In this regard, the Directive raises a number of questions, e. g. what criteria should be taken into consideration? On the one hand, Art. 29 sec. 3 stipulates that the Solvency II rules are to be applied in a manner proportionate to the “nature, scale and complexity of the risks

inherent in the business”, indicating that only the insurer’s risk profile has to be considered. However, on the other, Art. 29 sec. 4 obligates the Commission to ensure “the proportionate application of this Directive, in particular to small insurance undertakings”, implying that the undertaking’s size is also to be taken into account. This may cause severe problems, such as in the case of a small undertaking with

a complex risk profile that seeks permission to use certain simplifications, e. g. regarding the calculation formula for its capital requirements or the complexity of its governance system. The question then arises whether the insurer can be allowed such simplifications on the basis of the proportionality principle.

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<http://www.springerlink.com/content/t1x7412844174225/>

EMPLOYING INDIVIDUAL MINDFULNESS TO MITIGATE INFORMATION OVERLOAD IN FINANCIAL ORGANIZATIONS



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In the financial services industry, employees have access to a large amount of information that is provided by enterprise IT systems. In such an environment, too much information can lead to information overload. The negative consequences of information overload can be counteracted by a high degree of cognitive mindfulness among the users of these systems. Hence, we analyze the interplay between information overload and mindfulness with regard to the realization of business process outcomes. The results suggest that the presence of information overload decreases the use of IT systems and reduces the overall business process outcome. However, we also find that cognitive capabilities in the form of mindfulness can mitigate the negative consequences of information overload.

The ever-increasing availability of digitized information in financial organizations demands an increased cognitive processing capability on the part of employees in order to master the difficult task of dealing with all of this information. In extreme cases, if the information load

or time constraints are too high and the cognitive processing capabilities present too low, a situation of information overload is likely to occur. While the extant literature posits a strong positive relationship between information load, information processing and decision quality, there is also evidence that information overload can counteract the possible gains to be derived from using IT systems (Edmunds and Morris 2000). The prospect of information overload decreases the likelihood of using an enterprise IT system and of realizing the business value related to its use. Consequently, cognitive capabilities are required to meet the challenge of information overload. Among such capabilities, individual mindfulness is assumed to account for the effective processing of context-relevant information in highly dynamic industries (Dane 2010). In essence, mindfulness reflects a state of high situational awareness and contextualized decision making (Langer 1989) that is required to realize business value from complex enterprise IT systems.

In order to validate the hypothesized relationships between enterprise systems use, information overload, mindfulness and business

process outcomes, we conducted a questionnaire-based study of 489 professionals from the sales department of a large German financial services provider. In their place of work, a new customer relationship management (CRM) system was implemented whose subsequent use was mandatory to all employees. The results of partial least squares (PLS) analyses based on 221 complete responses indicate that use of the new CRM system serves to increase business process outcomes in terms of flexibility, effectiveness, and efficiency.

Employees that are exposed to a high degree of information overload are more likely to avoid using the IT system, as this would lead to an even higher information load. As a result, for such users, the costs associated with using the IT system may outweigh the related benefits, thereby decreasing the probability of reuse. Consequently, we propose the following hypotheses.

H1: Information overload negatively influences the use of the enterprise system.

The literature suggests focusing on the analysis of business value at the process level, since

IT investments are likely to impact the process level first. The extent to which using IT provides banks with more flexibility, effectiveness and efficiency is reflected in the increase in business process outcomes. Consequently, we propose hypothesis two below.

H2: The use of the enterprise system positively influences business process outcomes.

A high degree of information overload, as represented by a high information load, can thwart the positive effects of IT use. Prior research indicates that information overload eventually leads to a situation where less information is utilized. Additionally, information overload has a direct negative effect on the quality of decision making and the time that this requires. This adversely affects potential business process outcomes, e. g. a large amount of available information can increase the time-to-market for new financial products since it takes longer to process all the available data.

H3: Information overload negatively impacts business process outcomes.

At the level of the individual user, the extant management literature indicates that mindfulness positively influences individual task performance, especially in complex and dynamic settings. More precisely, individual mindfulness facilitates the identification and creation of contextually relevant material, i. e. based on all the information available. Through these

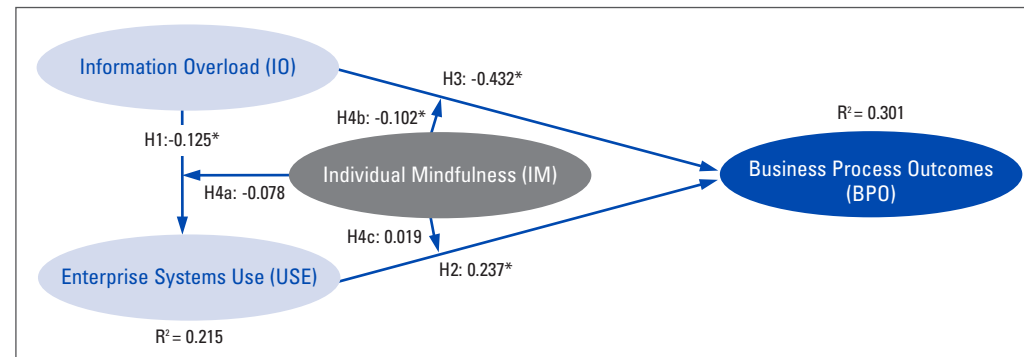


Figure 1: Estimates for the research model – * $p < .05$ (two-tailed)

mechanisms, mindfulness is likely to increase the benefits realized from enterprise IT systems where usage is negatively affected by information overload.

H4a: Individual mindfulness negatively moderates the relationship between information overload and enterprise systems use.

H4b: Individual mindfulness negatively moderates the relationship between information overload and business process outcomes.

Since individual mindfulness is reflected in a consideration of new, alternative solutions and a highly context-dependent systems use, a close matching of business requirements and utilized IT capabilities is more likely, leading eventually to the improved business process outcomes that arise from IT utilization (Wolf et al., 2010). Usually, firms that exhibit a high extent of mindfulness are likely to achieve superior organizational performance.

H4c: Individual mindfulness positively moderates the relationship between enterprise systems use and business process outcomes.

Overall, four (H1, H2, H3, H4b) of the six hypotheses are supported by the results (see Figure 1). The estimated explained variance (R^2) for the endogenous latent variables adjusted R^2 values of 0.215 for enterprise systems use (USE) and 0.301 for business process outcomes (BPO) indicate a moderate amount of explained variance. Information overload negatively affects usage of the CRM system in a twofold way. First, it has a direct negative impact on the actual use of the CRM system itself. Second, it negatively affects the business process outcomes realized from using the CRM system. Finally, this relationship is moderated by individual mindfulness indicating that the presence of mindfulness among the CRM system's users helps mitigate the possible negative consequences of information overload on the benefits realized

from its use. Surprisingly, we find no evidence of mindfulness having a moderating impact on the business process outcomes generated by enterprise IT systems use and of decreased system use due to higher levels of information overload.

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HIGH-FREQUENCY TRADING – A EUROPEAN PERSPECTIVE



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The flash-crash of the U.S. stock market on May 6, 2010 has drawn massive public attention to High Frequency Trading (HFT). The use of computers in trading processes has enabled market participants to dramatically speed up the reception of market data, internal strategy calculation procedures, order submission and the reception of execution confirmations in recent years. A remarkable gap between the results of academic research on HFT and its perceived impact on markets in the public, media and regulatory discussions can be observed. While regulators around the globe are discussing whether there is a need for regulatory intervention into HFT activities, academic literature mostly finds positive effects of HFT based strategies on market quality. Our study provides an overview of the evolution of electronic trading as well as definitions and a delineation of Algorithmic Trading (AT) and HFT. Based on this background, we analyze the benefits and risks of HFT and discuss appropriate regulatory measures.

HFT is used by technologically advanced market participants to implement their trading strategies in a high speed technological environment. HFT is therefore not a trading strategy in itself, but rather uses the latest technological advances in market access, market data access and order routing to maximize the returns of established trading strategies. While HFT is a relatively new term, the underlying concept is not new at all. Since the advent of electronic markets, market participants have tried to minimize trading costs and to maximize their profits from electronic executions. From the first quote machines, to direct market access tools, to smart order routing systems, there is a clear evolutionary process in market participants' adoption of new technologies in changing market environments, triggered by competition, innovation and regulation.

HIGH-FREQUENCY TRADING IN ACADEMIC LITERATURE

The most prominent question regarding HFT is whether it is beneficial or harmful to the economy. Since academic interest in HFT is a relatively recent phenomenon, only few studies exist. Furthermore, empirical

research on HFT is restricted by a lack of accessible and reliable data. More research on this topic is highly desirable.

The available literature shows that HFT generally contributes to price formation and finds positive effects on liquidity and short term volatility (e. g. Brogaard 2010 and Groth 2011). Under certain circumstances, HFT has, however, also been found to increase the adverse selection problem and, in the case of the flash crash, one study documents that HFT exacerbated volatility (see Jovanovic and Menkveld 2010).

REGULATION OF HIGH-FREQUENCY TRADING BASED STRATEGIES

One argument commonly put forward when discussing potential issues emanating from the propagation of HFT is potential systemic risk arising from the activity. Such risks can be the result of malfunctioning/ rogue algorithms, which bombard a marketplace with orders until the marketplace's infrastructure is no longer able to cope with the amount of orders. The new possibilities of sophisticated IT can also be used to run abusive strategies against market integrity or to deliberately exercise disruptive or confusing effects on

other market participants. Such risks must be effectively combated by market regulation and supervision. However, any arguments that try to associate or equate HFT based strategies with market abuse miss the point; there is no ground for treating entities that are applying HFT different to other market participants in this respect.

Regulatory authorities should require entities running HFT based strategies to establish sophisticated risk management tools and operational safeguards. Users should be able to demonstrate that they are in full control of their algorithms at any time, for instance by logging and recording the algorithms' input and output parameters for supervisory investigations and back testing. Furthermore, the authorities should require market operators as well as clearing & settlement organizations to be able to handle peak volumes and to be capable of protecting themselves against technical failures in members' algorithms, for instance by requiring that a human trader, responsible for the algorithm, is always available during trading hours.

A EUROPEAN PERSPECTIVE

After the flash crash, a lot of regulatory changes relating to HFT were introduced in the U.S. In contrast, Europe is only in initial discussions whether and how to regulate HFT strategies. A lot of problems relating to HFT are

rooted in the U.S. market structure, the U.S. equity markets and the U.S. National Market System. In Europe, where a more flexible best execution regime is implemented by MiFID (European Commission 2004) and where a share-by-share volatility safeguard regime has been in place for nearly two decades, no market quality problems related to HFT have been documented so far. Because of these differences, a European approach to the subject matter is required and Europe should be cautious when addressing and fixing a problem that exists in a different market structure, thereby creating risks for market efficiency and market quality.

Any regulatory interventions in Europe should attempt to preserve the benefits of HFT while mitigating the risks as far as possible by assuring that (i) a diversity of trading strategies prevails and that artificial systemic risks are prevented, (ii) economic rationale rather than obligations drives the willingness of traders to act as HFT liquidity providers, (iii) co-location and proximity services are implemented on a level playing field, (iv) instead of market making obligations for HFT or minimum quote lifetimes, the focus is on the alignment of volatility safeguards among European trading venues that reflect the HFT reality and ensure that all investors are able to adequately react in times of market stress.

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THE RISK OF COMPROMISING ON PRICE STABILITY MUST NOT BE TAKEN



Norbert Walter was Chief Economist of Deutsche Bank Group from 1990 to 2009 and also Head of Deutsche Bank Research. Formerly a student of Goethe University Frankfurt and a research assistant at the Institut für Kapitalmarktforschung (today's Center for Financial Studies), he received his Ph.D. in Economics in 1971. From 1971 to 1986 he was a researcher at the Institut für Weltwirtschaft in Kiel, earning his professorship in 1978. In January 2010 he founded Walter & Daughters Consult.

The ECB's policy to buy the government bonds of highly indebted EU Member States is widely disputed. Do you share the opinion of Jean-Claude Trichet that there was no alternative to this measure?

I rarely dissent with Jean-Claude Trichet's views. However, concerning the purchase of bonds that are at risk of being downgraded because of unsustainable fiscal policy, I do. The

ECB is responsible for the provision of "last" liquidity. If solvency is at stake, the lender of last resort must be a government or, finally, a parliament. The risk of compromising on price stability must not be taken. While it is obvious that, in an emergency, quick action must be taken – and fiscal policy decisions are not always swift – one could have sympathy for asking the central bank to step in because this can act promptly. But this is not a good enough argument. The very fact that the Bank of Japan, the Bank of England and the Federal Reserve have purchased much higher sums of low quality assets does not make this argument any better. Not to be misunderstood – I do not share the market assessment of the risk premia for the government bonds of the PIIGS (Portugal, Ireland, Italy, Greece and Spain). Admittedly, proper premia were not as low as the market had assessed before 2008. But today's high risk premia are also unreasonable, particularly given that most of the peripheral countries have addressed their fiscal imbalances so aggressively.

Regarding a possible "haircut" on Greek government debt: Who will foot the bill – the financial industry or the tax payer?

If we are talking about a possible haircut, it is obvious that this is about the private sector taking part of the "hit" instead of the government and the tax payer footing the bill all alone. However, to judge a certain action – here, a haircut – it would be wise to consider several rounds of responses rather than just the impact effect, i.e. the first round. If a sizeable haircut were to wipe out the equity capital of some banks and insurance companies, and, if the capital markets were not to recover to swiftly recapitalize these financial institutions, the "too big to fail" doctrine could lead to the necessity of another financial market bailout. Thus, in the complete analysis, the haircut, i. e. the inclusion of the private sector to foot the "Greek" bill, would not have worked. The tax payer would pay; not for Greece, but for the banks.

To avoid further debt crises in the future, EU Member States recently agreed on a reform of the Stability and Growth Pact. Lacking automatic sanctions, was this reform worth the effort?

The short and longer term rescue packages are still incomplete. The Stability and Growth Pact, while amended, has not reached safer shores.

The lack of effective sanctions is certainly a major weakness. Thus, the inclusion of experienced players in such operations – particularly to ensure that the conditionality of the international assistance proves effective – is highly necessary; a fact barely understood after the demise of Lehman Brothers.

The new President of the Deutsche Bundesbank, Jens Weidmann, demanded a deficit reduction from the German government. How realistic was this appeal, given that Berlin has to pay 22 billion euros into the European Stability Mechanism (ESM) during the next five years?

The request for further deficit reduction is obviously appropriate, not just for Germany, but because of the structural deficit – resulting mainly from a negative demographic outlook – for quite a number of other European countries. The need to fund the ESM makes such efforts on the part of Germany even more relevant. Given the positive surprise encountered by the German Finance Minister regarding tax revenues – a consequence of the healthy economy in 2011 – a further reduction in the German government deficit seems to be achievable at this point in time.

SELECTED HOUSE OF FINANCE PUBLICATIONS

Angeloni, I., Faia, E., Winkler, R. (2011)
[“Debt Consolidation and Financial Stability”](#),
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 Institute for Law and Finance Working Paper
 No. 124, [http://www.ilf-frankfurt.com/uploads/
 media/ILF_WP_124.pdf](http://www.ilf-frankfurt.com/uploads/media/ILF_WP_124.pdf)

**Branger, N., Krautheim, E., Schlag, C.,
 Seeger, N.** (2011)
[“Hedging under Model Mis-Specification: All
 Risk Factors are Equal, But Some are More
 Equal than Others ...”](#),
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 Mitchell, O. S.** (2011)
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[“From Minutes to Seconds and Beyond: Mea-
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 Electronic Securities Markets”](#),
 forthcoming in *Proceedings of the 19th European
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**Christelis, D., Georgarakos, D.,
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[“Stockholding: Participation, Location, and
 Spillovers”](#),
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Cwik, T., Wieland, V. (2011)
[“Keynesian Government Spending Multipliers
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 forthcoming in *Economic Policy*

Friebel, G., Langenbucher, K. (2011)
[“Die Institutsvergütungsverordnung: Ist Ver-
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 möglich?”](#),
GWR – Gesellschafts- und Wirtschaftsrecht,
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 forthcoming in *Economics Letters*

Haar, B. (2011)
[“From Public Law to Private Law? Market
 Supervision and Contract Law Standards”](#),
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 (eds.), *Financial Crisis, Financial Services and
 General European Contract Law: Failure and
 Challenges of Contracting*, Wolter Kluwer

Hanewald, K., Post, T., Gründl, H. (2011)
[“Stochastic Mortality, Macroeconomic Risks
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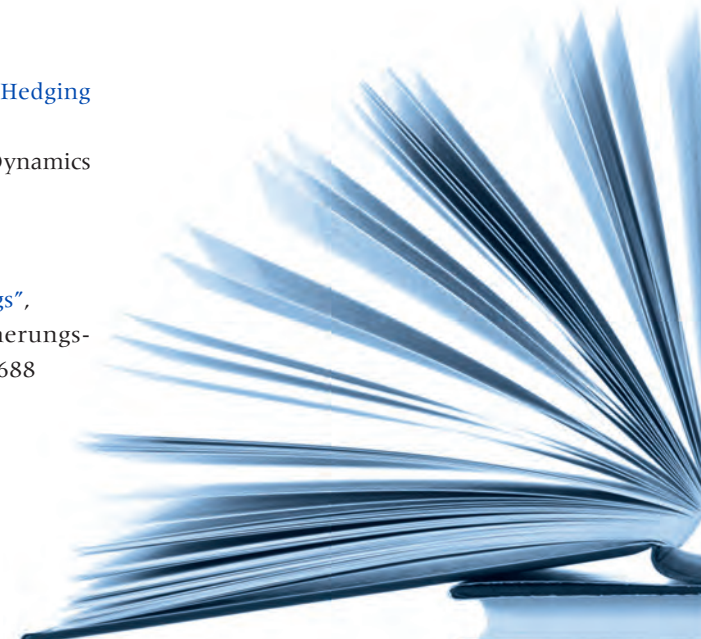
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Skiera, B., Bermes, M., Horn, L. (2011)
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Vykoukal, J., Pahlke, I., Beck, R. (2011)
[“Impact of Grid Assimilation on Operational
 Agility in Turbulent Environments: An Empirical
 Investigation in the Financial Services Industry”](#),
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 pean Conference on Information Systems (ECIS)*,
 Helsinki, Finland



GERMAN CHANCELLOR AT THE HOUSE OF FINANCE



Angela Merkel visited the House of Finance on March 23 to deliver a speech at the "Frankfurt Finance Summit 2011 – Smarter Regulation, Safer Markets". The German Chancellor spoke to a distinguished audience of decision makers from politics, the public sector, academia, and the financial industry about necessary reforms for financial markets regulation. The Summit's opening speech was given by Jean-Claude Trichet, the President of the European Central Bank. Meanwhile, the keynote speakers of the four panels held were Axel Weber, then President of the Deutsche Bundesbank, Luc Frieden, Luxembourg's Minister of Finance, Reto Francioni, the Chief Executive Officer of Deutsche Börse, and EU elder statesman Baron Alexandre Lamfalussy. Closing remarks were made by Josef Ackermann, Chairman of the Management Board and the Group Executive Committee of Deutsche Bank. The Summit was organized by Frankfurt Main Finance and the Frankfurt Institute for Risk Management in cooperation with the House of Finance.

GOETHE UNIVERSITY ESTABLISHES "HOUSE OF FINANCE FOUNDATION"

On March 23, Werner Müller-Esterl, the President of Goethe University, announced the establishment of a "House of Finance Foundation" at the annual meeting of the HoF Board of Trustees. The Foundation will start with an endowment of 12 million euros in free capital, three funded chairs, and more than 5 million euros from existing assurances to the HoF; all of which together are worth 21 million euros. President Müller-Esterl expressed his thanks not only to Deutsche Bank, DekaBank, DZ Bank, Deutsche Vermögensberatung, Landesbank Hessen-Thüringen as well as to Bankhaus Metzler, UBS, and the Gesamtverband der Deutschen Versicherungswirtschaft, but also to the Mayor of Frankfurt and the government of Hesse for their continuing support. Future talks with further potential donors should expand the Foundation's capital stock.

SWEDISH MINISTER OF FINANCE A GUEST OF THE IMFS



On May 18, Anders Borg, Sweden's Minister of Finance, gave a speech on "Ensuring Fiscal and Financial Stability in Europe – Lessons from Sweden" at the Hessische Landesvertretung in Berlin at the invitation of the Institute for Monetary and Financial Stability (IMFS). After a few words of welcome by Luise Hölscher from the government of Hesse, Borg outlined the Swedish success story. He explained how a nation that was previously a severe debtor could become one of the most fiscally sound countries in Europe by means of surplus targets, expenditure ceilings, balance requirements, and a stringent budget controlling process. Jörg Asmussen, State Secretary in the German Ministry of Finance, attended the event on behalf of the German Government.

VOLKER WIELAND A LEAD SPEAKER AT G20 HIGH-LEVEL SEMINAR



On March 31, Volker Wieland, Professor of Monetary Theory and Policy at the House of Finance, was invited to be a lead speaker at the G20 High-Level Seminar on the international monetary system in Nanjing, China. He contributed to the session on global liquidity management issues with a speech on "Liquidity Management and the Reform of the International Monetary System". This seminar was initiated by the French G20 Presidency. It was the first time that academic researchers have been invited to share their knowledge in an exchange with G20 finance ministers, central bank governors and their deputies. Conference speakers included the Chinese Vice-Premier Wang Qishan and the French President Nicolas Sarkozy.

STEFAN GERLACH TO ADVISE THE EUROPEAN SYSTEMIC RISK BOARD



Stefan Gerlach, Executive Director of the Institute for Monetary and Financial Stability (IMFS) and Professor of Monetary Economics at the House of Finance, has been appointed a member of the Advisory Scientific Committee (ASC) of the European Systemic Risk Board (ESRB). The ASC consists of 15 experts who provide advice and assistance on issues relevant to the work of the ESRB at the request of the Chair of the General Board. Members are appointed for a renewable term of four years.

FIRST CORPORATE FINANCE AWARD PRESENTED

On May 26, the business daily Börsen-Zeitung presented its first Corporate Finance Award to Merckle Group in recognition of their portfolio rebuilding and their financial restructuring. The award was bestowed during the Corporate Finance Summit jointly organized by the Commerzbank and the Institute for Law and Finance (ILF) at the House of Finance. Andreas Cahn, Professor at the ILF, was a member of the jury. This had to consider a shortlist of five strategically and financially exceptional transactions or restructurings; all of which had taken place in 2010 and proven outstanding in terms of size, complexity, speed, and originality.

QUARTERLY EVENT CALENDAR

| JULY | | JULY | | SEPTEMBER | |
|---|--|---|---|--|---|
| Friday, 1 st 8.30 am – 7 pm | CFS Research Conference “International Conference on Payout Policy – Foundations and Trends” | Saturday, 16 th 6 pm | Institute for Law and Finance Graduation Dinner | Sunday, 4 th – Wednesday, 7 th | Verein für Socialpolitik Annual Congress 2011 “The order of the world economy: Lessons from the Crisis” |
| Monday, 4 th 5 pm | EFL Jour Fixe “Measuring the Perceived Usefulness of Corporate Communication Technologies in the Financial Services Industry” Speaker: Sven Weber | Friday, 29 th 2.30 pm | MathFinance Kolloquium Speaker: Jaksa Cvitanic, California Institute of Technology | Wednesday, 7 th – Thursday, 8 th | International Center for Insurance Regulation “Transatlantic Insurance Group Supervision” Conference, organized by ICIR, EIOPA, NAIC |
| Tuesday, 5 th 12.15 pm – 1.45 pm | Frankfurt Seminar in Macroeconomics Speaker: Jaroslav Borovicka, Chicago Fed / University of Chicago | AUGUST | | Wednesday, 7 th – Saturday, 10 th | Goethe Business School “Financial Risk Management – Part I” |
| Wednesday, 6 th 12 pm – 1 pm | Finance Brown Bag Seminar “Corporate Cost of Borrowing: TRACE on Syndicated Loans” Speaker: Markus Fischer | Monday, 22 nd – Saturday, 27 th 10 am – 6 pm, daily | Ph.D. Program Law and Economics of Money and Finance Summer School “Empirical Law and Economics” Speaker: Jonathan Klick, Davis Abrams, University of Pennsylvania Law School | Thursday, 8 th – Friday, 9 th | Seventh International Longevity Risks and Capital Markets Solutions Conference Organization: Raimond Maurer |
| Thursday, 7 th 12.15 pm – 1.45 pm | Frankfurt Seminar in Macroeconomics “Coordination Failures in Immigration Policy” Speaker: Michele Ruta, World Trade Organisation | Monday, 22 nd – September, Friday, 2 nd 9 am – 5 pm daily | Institute for Law and Finance Summer School “Banking and Capital Markets Law” | Tuesday, 20 th 5.30 pm | CFS Colloquium “Konvergenz internationaler Rechnungslegungsstandards und die Rolle des Standard Setters” Speaker: Clemens Börsig, Chairman of the Supervisory Board, Deutsche Bank |
| Tuesday, 12 th 5.15 pm | Finance Seminar Speaker: Olesya V. Grishenko, Smeal College of Business, Penn State University | Wednesday, 31 st 5.30 pm | CFS Colloquium “Die Wettbewerbsfähigkeit des deutschen Finanzsystems” Speaker: Wolfgang Kirsch, Chief Executive Officer, DZ Bank | Thursday, 22 nd 11 am – 10.30 pm | Center for Financial Studies Deutsche Bank Prize Symposium and Award Ceremony |
| Wednesday, 13 th 12 pm – 1 pm | Finance Brown Bag Seminar “The Role of Agents' Heterogeneity in International Financial Markets and Monetary Economics” Speaker: Oliver Berndt | | | | |
| Thursday, 14 th 5.15 pm | MathFinance Kolloquium Speaker: Frank Riedel, University of Bielefeld | | | | |

Please refer to www.hof.uni-frankfurt.de/eventlist.html for continuous updates of the event calendar.



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